No. 11959

United States
Circuit Court of Appeals
For the Ninth Circuit

INDEPENDENCE LEAD MINES COMPANY, an Arizona Corporation,
Appellant,

v.

ALMA R. KINGSBURY and OLGA MARQUARDT,
Appellees.

Appellant's Opening Brief

Upon Appeal from the District Court of the United States for the District of Idaho, Northern Division

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JURISDICTION

This action was originally brought by the plaintiffs, Alma R. Kingsbury and Olga Marquardt, who are citizens and residents of the State of Idaho, against the defendant, Independence Lead Mines Company, a corporation, and a citizen and resident of the State of Arizona. The action was brought to compel the defendant to distribute and deliver to the plaintiffs certain shares of the stock of Clayton Silver Mines, Inc., to which plaintiffs claimed they were entitled by reason of their ownership of certain stock, designated as "common stock Class A" in the defendant corporation, and which they claimed entitled them to the pro-rata distribution of a stock dividend of Clayton Stock declared by the defendant. Plaintiffs asked an alternative money judgment in excess of $3,000.00 (tr. 9).

The controversy was therefore a controversy which at the time of the commencement of the action was, and still is, entirely between citizens of entirely different states, and the amount in controversy is, and was at the time of the commencement of the action in excess of the sum of $3,000.00.

The jurisdiction of the District Court existed under Section 41, Title 28, U. S. C. A., Judicial Code, Section 24 amended. The appeal to this Court is from an order granting the motion to dismiss of the appellees, dated the 9th day of February, 1948 (tr. 79, 80), and from a final order dismissing petition to vacate and set

aside judgment, dated the 16th day of February, 1948, and entered March 30, 1948. Notice of appeal was filed in the office of the Clerk of the District Court on the 12th day of May, 1948, and jurisdiction is believed to exist under Section 225, Title 28, U. S. C. A., being Judicial Code, Section 128 as amended.

STATEMENT OF THE CASE

This is an action based upon a petition of the appellant, Independence Lead Mines Company, to vacate and set aside a judgment heretofore entered against the appellant corporation and in favor of the appellees, Alma R. Kingsbury and Olga Marquardt. Judgment sought to be reopened was signed on the 24th day of June, 1946, and filed June 29, 1946.

Plaintiffs, Alma R. Kingsbury and Olga Marquardt (being appellees in this cause) brought an action in the District Court of the United States for the District of Idaho, Northern Division, against the defendant (appellant herein) setting forth that appellant's original authorized capital stock was divided into 4,000,000 shares of a par value of $1.00 per share and that such stock was divided into two kinds of stock, there being 3,000,000 shares designated as "common" stock and 1,000,000 shares designated as "preferred" stock; that the preferred stock was non-assessable and had certain preferences otherwise. Complaint stated that on February 10, 1932, the stockholders, by resolution duly adopted at a stockholders' meeting, amended the Articles of Incorporation of the appellant and eliminated the preferred stock, authorizing in lieu of said stock 1,000,000 shares of so-called common stock Class A and providing that such stock should be non-assessable; that the appellant corporation for value received issued to the Mines Finance Corporation, an Idaho corporation, upon the amendment, the 1,000,000 shares of common stock Class A and that on the 31st

day of December, 1941, the Mines Finance Corporation assigned and transferred 666,667 shares of the common stock Class A to appellee, Alma R. Kingsbury, and 333,333 shares to one Herman Marquardt, now deceased, husband of appellee, Olga Marquardt; that thereafter the appellant corporation issued 666,-667 shares of said common stock Class A to Alma R. Kingsbury, and after probate of the said estate of Herman Marquardt, Olga Marquardt, appellee, received 333,333 shares of the common stock Class A. The appellees in their original action set out that the appellant, Independence Lead Mines Company, acquired 1,001,000 shares of the Clayton Silver Mines, Inc., an Arizona corporation, and that said Independence Lead Mines Company authorized the distribution on September 1, 1944, of most of this Clayton stock to the shareholders of the Independence Lead Mines Company on the basis of one share of Clayton to each four shares of the Independence Lead Mines stock owned by the various stockholders; that the Independence Lead Mines Company, appellant here, refused to distribute any of the Clayton stock to the appellees who claimed that their common stock Class A was entitled to enjoy all of the rights, privileges and benefits of the other common stock of the Independence Lead Mines Company (tr. 4, 5, 6, 7, 8). Appellant, Independence Lead Mines Company, filed motion to dismiss in the District Court on July 25, 1945, and the same was denied on November 30, 1945 (tr. 34, 35), and appellant filed its answer on April 29, 1946, in which answer the appellant denied that 1,000,000 shares

of common stock Class A were ever lawfully issued. Appellant further denied that there was any consideration of any nature whatsoever for any of the transfers alleged by appellees to them of the common stock Class A. The appellant corporation in its answer contended that the transfers of the common stock Class A to the appellees constituted a fraud on the corporation (tr. 38, 39, 40, 41, 42). Appellees amended their complaint and filed said amended complaint on May 22, 1946 (tr. 43, 44, 45). They asked that in the event the appellant was unable to deliver the proper ratio of stock that it be compelled to make the plaintiffs whole by payment to them of stocks and cash. On the 22nd day of June, 1946, appellant and appellees, through counsel, entered into a stipulation (tr. 45, 46, 47), which stipulation was incorporated in a judgment and decree entered the 24th day of June, 1946 (tr. 48, 49, 50), whereby appellees were to surrender 400,000 shares of the common stock Class A of the appellant corporation and were to have and to receive in return 170,000 shares of the Clayton Silver Mines stock and $10,050.00 in cash. The judgment also decreed that appellee, Alma R. Kingsbury, was the bona fide owner of 400,000 shares of the common stock Class A of the appellant corporation, and that appellee, Olga Marquardt, was the bona fide owner of 200,000 shares of the common stock Class A of the appellant, Independence Lead Mines Company, and that all of said stock has, possesses and is entitled to the same identical rights, privileges and benefits as the common stock of the appellant, Independence Lead Mines Company. The order

decreed that the only difference between the common stock and the common stock Class A was that the latter was not subject to assessment (tr. 49, 50).

On June 23, 1947, appellant corporation, Independence Lead Mines Company, filed its motion to vacate and set aside judgment (tr. 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64), hereafter referred to as the petition, and on December 11, 1947, filed its amendment to motion to vacate and set aside judgment and reopen said cause to allow Independence Lead Mines Company to file a proper answer and to reopen said cause for trial, which will hereafter be referred to as the amended petition (see amended petition of appellant in appendix, infra p. 34).

The amended petition set forth that at the time of the amendment of the appellant Independence Lead Mines Company's Articles of Incorporation to create the common stock Class A designation, that representations were made by the Independence Lead Mines Company's president and secretary to all of its stockholders that said stock would be held in the treasury of the company and would only be exchanged for the purchase of other mining properties; that no mining properties were purchased pursuant to the representations made to the stockholders; that Henry B. Kingsbury and Herman Marquardt in about the year 1923 were the president and secretary of the Independence Lead Mines, Ltd., the predecessor in interest to the appellant, Independence Lead Mines Company, and that they formed the Mines Finance Corporation, of

which Henry B. Kingsbury became president and Herman Marquardt became secretary and of which company they were the sole stockholders (tr. 51, 52, 53). The amended petition alleged that the purpose of the Mines Finance Corporation was to take and receive the funds of the Independence Lead Mines, Ltd., which were secured by the levying of assessments on the common stock of the latter company; that the Mines Finance Corporation had no source of revenue or income. The amended petition set forth that thirteen assessments were levied upon the appellant company for the benefit of the Mines Finance Corporation and Henry B. Kingsbury and Herman Marquardt; that during or shortly after the year 1930 the said Kingsbury and Marquardt controlled absolutely the appellant corporation here and the Mines Finance Corporation and that they secured to themselves the 1,000,000 shares of common stock Class A of the appellant, Independence Lead Mines Company, fraudulently and without any consideration; that by reason of the deaths of Henry B. Kingsbury and Herman Marquardt, the present appellees, who are the widows of said deceased persons, came into the possession and alleged ownership of the 1,000,000 shares of common stock Class A of the Independence Lead Mines Company; that Henry B. Kingsbury and Herman Marquardt had defrauded the company and all of its stockholders by making no distinction in the certificates of the Independence Lead Mines Company of the classes of the stock, and that they had, by keeping permanent control of the appellant corporation, caused the fraudulent issue of the

common stock Class A to be made (tr. 54, 55, 56, 57, 58). The amended petition alleged that since the death of Herman Marquardt in August of 1942, the appellant corporation had been controlled and dominated by one F. C. Keane of Wallace, Idaho, who acted as president without any right or authority, as he had not been a stockholder since some time in the year 1940, and that the said Keane had appointed two other directors who likewise had no right or authority to act as such; that this Board of Directors in August of 1944 had caused a resolution to be passed providing for the payment of Clayton stock as dividends to the holders of Independence Lead Mines Company stock, on a one to four ratio, and specifically declaring in the resolution that the Class A common stock should not participate because of a question as to its validity (tr. 66, 67, 68); that said F. C. Keane, who was in complete control of the appellant corporation, had sold and disposed of almost all of the assets of the company for his own use and benefit, as had been set forth in a complaint for receivership (tr. 82), which complaint also alleged that said Keane had misappropriated the property of the appellant corporation and had withheld information required by the regulations of the Securities and Exchange Commission for a number of years while he was engaging in his misappropriations. The amended petition also alleged that the appellees have been for some time by far the largest stockholders of the appellant corporation and that they lived in the Town of Wallace, Idaho, where said company maintained its principal office, and that they also maintained and

operated the largest brokerage business in Wallace, known as Pennaluna and Company, and that they knew of the affairs of the appellant corporation and that they knew that the company had no legal Board of Directors and that they knew that F. C. Keane was applying the proceeds of the sale of Independence Lead Mines Company assets to his own use and was dissipating the same. It was also alleged that the appellees were such large stockholders of the appellant corporation that they were in virtual control and that they would not interfere with the said F. C. Keane because they knew they could get a good settlement in the cause of action instituted by them if they did not do so; that in July of 1945 the appellees here and their attorney, in writing notified the Clayton Silver Mines, Inc., to stop any further transfers of Clayton stock belonging to Independence Lead Mines Company, and that the appellees threatened an injunction action, and that they knew about the dissipation of the appellant's funds prior to bringing their action in the District Court against the appellant, and did nothing about it (tr. 71, 72). The amended petition also alleged that knowledge of the misappropriation by the said F. C. Keane of the funds of the Independence Lead Mines Company was known by the appellees prior to any settlement and that the said F. C. Keane had sent one John Sekulic, an emissary of his, to the appellees to propose to them a settlement and to show them, the appellees, that they had better take a settlement of all of the remaining stock of the Clayton Silver Mines, Inc., owned by the Independence Lead Mines Company, to-wit,

170,000 shares; that the said emissary Sekulic was paid $10,000.00 to arrange this settlement, and that after said negotiations between Keane, Sekulic and the appellees, the stipulated judgment heretofore referred to was entered (tr. 73, 74, 75, 76). The amended petition alleged that Sekulic informed appellees that they had better accept his offer or take nothing, and that appellees were fully advised as to Keane's activities but settled with him even though the validity of their common stock Class A was in dispute.

Motion to dismiss was filed by appellees on the 15th day of December, 1947 (tr. 79). Orders of dismissal were entered, pursuant to argument, by the District Court (tr. 79, 80, 81, 82). The principal question that the District Court had to decide was whether or not there was fraud participated in by the appellees, in view of their knowledge of the appellant corporation's affairs, their relationship to the appellant corporation, and their activities and dealings with the appellant corporation and its so-called president and Board of Directors, in the entry of the stipulated judgment against the appellant, Independence Lead Mines Company.

SPECIFICATIONS OF ERROR

(1) The District Court erred in sustaining the motion to dismiss of the appellees directed against the appellant's amended motion or petition because the facts in such petition clearly alleged participation by the appellees in fraud in the procurement of the judgment against the appellant.

(2) The District Court erred in sustaining the motion to dismiss of the appellees directed against the appellant's amended motion or petition because the amended motion or petition clearly shows that the so-called officers and directors of the appellant had no capacity to bind the appellant, which the appellees well knew, and because the appellees had means of knowledge and actual notice of all of the affairs of the appellant and were charged by such notice that they were dealing with the appellant's so-called president and officers at their peril.

(3) The District Court erred in sustaining the motion to dismiss of the appellees directed against the appellant's amended motion or petition because the amended motion or petition clearly alleges such knowledge by the appellees of the appellant corporation's affairs that there was a duty on their part to refrain from acting or collaborating or participating with the appellant's so-called president or directors, and because there had been sufficient notice to them that said directors were not legal directors or defacto di-

rectors or entitled in any way to act for the appellant corporation.

(4) The District Court erred in sustaining the motion to dismiss of the appellees directed against the appellant's amended motion or petition because the facts alleged in the petition conclusively show the existence of extrinsic fraud in the procurement of the judgment and in the participation of the procurement of said judgment by the appellees, and the amended motion or petition further clearly shows and alleges that the appellees did participate in the fraudulent procurement of the judgment and thereby participated in the fraud upon the appellant and upon the court.

SUMMARY OF ARGUMENT

The facts alleged in the amended petition will be considered as admitted in view of the appellees' motion to dismiss. The amended petition of the appellant seeking to reopen a judgment and decree heretofore entered by stipulation between appellees and appellant on the 24th day of June, 1946, alleges extrinsic fraud and a connivance, collusion and participation in such fraud by the appellees. The amended petition likewise sets up an adequate defense to appellees' alleged cause of action set forth in their original complaint against the appellant which sought a distribution of appellant's dividend stock (tr. 2-10). It is not material whether the amended petition be designated a motion or a petition. It can be treated as an independent action in the nature of a bill of review.

The amended petition clearly shows the existence of extrinsic fraud and the participation by the appellees in the same. The appellees did not stand in relation to the appellant corporation as an ordinary small or minority stockholder. In addition to the above, they were by far the largest single stockholders in the appellant corporation and they had intimate knowledge of the affairs of the appellant corporation because of their relationship to the individuals who controlled the corporation, to-wit, their husbands. They likewise were familiar with the affairs of the appellant because they were both active in the management of a brokerage firm which was the largest in the vicinity where the appellant had its principal offices and mining prop-

erties and which afforded them an intimate knowledge of mining corporation activities. The appellees were duty bound to refrain from acting or collaborating with the president of the appellant corporation and the appellant corporation, in view of the fact that they had complete knowledge of the defalcations in the affairs of the appellant, and they knew that in the settlement in which they participated with the president of the appellant, they were taking all of the Clayton stock held by the appellant for distribution as dividends, to the exclusion of all the other stockholders of the appellant corporation who legally were entitled to a pro rata distribution of the dividend stock. The appellees were duty bound not to deal with the president of the appellant because they had actual knowledge that the president was not legally authorized to act on behalf of the appellant, and they therefore knew that they were dealing with such a person. The appellees knew that the president had misappropriated great amounts of the Clayton stock which was held by the appellant as a trust to be distributed by the appellant to its common stockholders, and they were advised that the 170,000 shares of Clayton Silver Mines stock which they accepted from the appellant in the stipulated judgment was all that the appellant corporation had left to distribute to all of its holders of common stock. The appellees knew that no assessments had ever been paid on their common stock Class A and that the common stockholders who had paid assessments for many years to finance the appellant corporation could not receive any dividend if they, the appellees, received all the

dividend stock. The appellees did not deal, in view of their intimate knowledge of the affairs of the appellant and their actual knowledge of the illegality of any action of its president or Board of Directors, with its president or Board of Directors as stockholders or third parties dealing with defacto directors. The appellees knew that the president of the appellant corporation and the directors were not defacto or dejure officers of the appellant and they knew of this fact and they had likewise been advised through an emissary of the defalcating president of the appellant corporation that the only proposition that the president of the appellant would make to them to settle their claims in view of the condition he himself had unlawfully created with appellant corporation's affairs, was the offer finally incorporated in the stipulated judgment. The appellees made their settlement with the appellant corporation not by any compromise arising from a debatable determination of the validity of their claim but because they knew of the unlawful acts of the president and could secure all of the Clayton Silver Mines stock held by appellant if they took no further action against the president of the appellant or the appellant itself.

ARGUMENT

I.

The Amended Petition

The amended petition set out in full in the appendix (see page 34, infra) alleges the facts upon which the appellant seeks to reopen the judgment of the court heretofore entered on the 24th day of June, 1946 (tr. 48, 49, 50). The facts in the amended petition comply with the necessary requisites of an independent action in the nature of a bill of review. The amended petition not only sets forth allegations of extrinsic fraud in the procurement of the judgment heretofore referred to, and the connivance, collusion and participation in the fraud by the appellees, but it likewise sets up a meritorious and adequate defense to the alleged cause of action originally brought by the appellees against the appellant corporation in which they secured the entry of a stipulated judgment. Regardless of the designation of the pleading seeking to reopen the judgment, the court can treat the same as an independent action in the nature of a bill of review.

> *Oliver vs. City of Shattuck,* 157 F. (2d) 150, 152 (CCA 10th 1946).

In the above case, at page 153, the court states:

> "* * * without pains to label the form of the action or the remedy * * *"

Also see:

Norris vs. Camp, 144 F. (2d) 1, 4 (CCA 10th 1944);

Fiske, et al vs. Buder, 125 F. (2d) 841 (discussion of Rule 60B).

II.

Errors With Respect to the Order of the Court Granting Appellees' Motion to Dismiss (1-4)

It may be suggested that the errors assigned in the ruling of the court on the appellant's petition to reopen have been condensed in the principal question which was before the District Court for decision (see page 11, supra). The consideration of the errors will therefore be combined in a chronological argument.

The amended petition alleges participation by the appellees in fraud in the procurement of the stipulated judgment (tr. 50-64, incl., tr. 65-76, incl., appendix page 34). The allegations heretofore referred to in the record as being included in the whole amended petition specifically show that the fraud complained of here is of extrinsic character. The entire amended petition itself is a narration of such fraud that it is a hypertechnical problem to segregate just exactly what might be considered as fraud of other than an extrinsic nature. The rule applicable here is set out in *Cyclopedia, Federal Procedure,* Vol. 8, Page 386 et seq.:

"Any wilful misrepresentation inducing the court to render an improper and unjust decree or to include improper provisions may be made the basis of such an application, as where the court is induced by misrepresentations of fact to sign the particular decree.

"One of the most troublesome distinctions in the law, almost as celebrated as that between 'latent' and 'patent' ambiguities in applying the parol evidence rule, is that between 'extrinsic' and 'intrinsic' fraud as ground for equitable relief from a judgment. That understanding of jurisprudence, which the legal profession at least should have, would have been furthered by discarding such expressions long ago; but they seem to have some unfortunate and perpetuating allure.

"Sometimes it has been sought to fasten the distinction upon the difference between fraud upon the court and other fraud; but this requires at least a broad view of what constitutes fraud 'upon the court' as the conduct or deceit which commonly forms the basis for relief is directed at the opposite party, deceiving him, rather than the court. *Probably no universally satisfactory test can be laid down.*" (Emphasis supplied.)

Likewise in *Hanna vs. Bricton Manufacturing Company,* 62 Fed. (2d) at Page 139:

"Without drawing nice distinctions between extrinsic and intrinsic fraud, a decree will be set aside for fraud which clearly prevented the making of a full and fair defense."

It is an accepted maxim that every court has inherent power which is not dependent upon any statute,

to control or vacate its own decrees when the interests of justice so require.

The appellees herein participated in fraud and connived, within the definition of the term, with the alleged president of the appellant corporation and its alleged board of directors (tr. 65-76, incl., appendix page 34) and none of the transactions by which appellees secured common stock Class A or transactions prior thereto concerning said stock, engaged in between predecessors in interest of the appellees and the appellant corporation, were known to the appellant's new and legal board of directors until about the 26th day of May, 1947 (tr. 62, 75, 76, appendix pages 53, 51, 52), Webster defines connivance in law as being:

> "corrupt or guilty assent to wrongdoing not involving *actual* participation in it, *but knowledge of and failure to prevent or oppose it . . . a passive consent or cooperation.*" (Underscoring supplied.)

In this connection the appellant submits that where any person wilfully abstains from any attempt to prevent misconduct which he knows is occurring and is further likely to occur, then he should be held to have connived in such misconduct within the meaning of the definition. This must be surely so where such a person knowingly profits as a result of wrongdoing known to him. It would not be necessary that appellees instigated the fraud, although it appears that instigation is a fairly descriptive term if the entire transactions set forth in the amended petition between the

appellant corporation, the predecessors in interest of the appellees, and the appellees are considered.

The situation presented here is not a situation that concerns minority stockholders dealing with the appellant corporation nor does it concern a majority stockholder dealing with a corporation at arm's length. The situation presented here is a course of dealing between the appellant corporation and the appellees where the appellees because of their relationship to the corporation had actual knowledge of the corporation's affairs, and also had, because of their large stock ownership and active interest and dealings with the appellant, an actual domination of the corporation (tr. 71, 72, appendix pages 47, 48, 49).

In *Fletcher Cyclopedia Corporations,* Permanent Edition, Vol. 13, Section 5811 at Page 127, we find:

> "A stockholder, even though he owns a majority of the stock, does not occupy a trust relation towards the other stockholders merely because of his holding of such stock, and it has been vigorously asserted that majority stockholders are in no case trustees for the minority. But while, in a narrow and restricted sense, it cannot be said that the holder or holders of the majority of the stock occupy a relation of trust, yet it can be said, in a larger and broader sense, that they sustain a fiduciary relation to the holders of the minority stock and the corporation. *And according to most of the decisions, a trust or fiduciary relation arises under certain circumstances. The actual control of the property "is the basis in all of the cases of the trust relation."* Thus it is held that when a number of stockholders combine to constitute them-

selves a majority in order to control the corporation as they see fit, *they become for all practical purposes the corporation itself,* and assume the trust relation occupied by the corporation towards its stockholders. It has been held that if a majority stockholder actually dominates the company, although not himself an officer, through his control of a majority of the board of directors, he stands in the same fiduciary relation to the other stockholders as he would sustain if he were a director or other officer. Of course, if a majority stockholder is also a director and the president or other chief officer of the corporation, he is a trustee." (Emphasis supplied.)

Levy vs. American Beverage Corp., 265 App. Div. 208, 38 N. Y. S. (2d) 517;

Dodge vs. Scripps, 179 Wash. 308, 37 P. (2d) 896, 900;

In re Los Angeles Lumber Products Co., 46 F. Supp. 77.

Majority stockholders are obliged to act in good faith as far as the rights of the minority stockholders are concerned.

"Majority stockholders, to the extent to which they control the corporation, must act in good faith, as far as the rights of minority stockholders are concerned. Their transactions must be free from fraud, and must not amount to a wanton destruction of the rights of the minority. It is a breach of duty to manipulate the business of the company in their own interests to the injury of minority stockholders. However, there is no duty on the part of majority stockholders to assist the corporation financially in its money difficulties and thereby shield it from financial destruction."

(*Fletcher Cyclopedia Corporations,* Permanent Edition, Vol. 13, Sec. 5810.)

Dodge vs. Scripps, 179 Wash. 308, 37 P. (2d) 896, 900;

Morse vs. Metropolitan S. S. Co., 87 N. J. Eq. 217, 100 Atl. 219, 221, 222;

In re Kansas City Journal Post Co., 51 F. Supp. 1009.

Likewise, a majority of stockholders cannot help themselves to all of the corporate assets to the absolute exclusion of minority stockholders. (See Sec. 5785, *Fletcher Cyclopedia Corporations,* Permanent Edition, Vol. 13, which says:

"Majority stockholders have no power to distribute or divide corporate assets among themselves, to the exclusion of minority stockholders. If they do so, minority stockholders may, in a proper case, obtain relief by a suit in equity. However, owners of all the stock may dedicate the corporate property to their private use, where there are no creditors or third persons who may object.")

Heimbaugh vs. Hitchcock, 115 Kansas 182, 222 Pac. 114.

In the case cited above, the majority owner of the preferred stock of a corporation, through his control of the corporation, manipulated a stock transaction which increased the valuation of his stock and decreased the valuation of the common stock held by the plaintiff. The court held that he could not increase the value of

the preferred stock held by him, at the expense of the plaintiff. The situation presented here is analogous to that under consideration by the court in the case cited (tr. 51-58, incl., appendix pages 35-42 incl). The appellees and their predecessors in interest were and became for all practical purposes the appellant corporation itself. In the present instance, of course, the manipulations alleged in the amended petition increased tremendously the value of the holdings of the predecessors of the appellees, at the expense of all of the other stockholders of the appellant corporation who had paid assessments for many years. Many of appellant's common stockholders were eventually deprived of receiving any dividends from the corporation in the form of distribution of Clayton Silver Mines stock held by it because of the actions of the appellees in taking all of such dividend stock held by the appellant, upon their claim, and subsequent acquiescence in an uncontested stipulated judgment that the non-assessable stock which they held was entitled to such a distribution. These benefits inured to the appellees by their participation and connivance in the stipulated judgment to which they were parties with knowledge of the illegality of the acts of the appellant's directors and defalcating so-called president of the appellant corporation. Appellees were parties to fraud because they knew of the defalcations of the president, had been advised of the defalcations, and had taken active steps with such knowledge to insure a subsequent settlement to them of all the appellant's dividend Clayton Silver Mines stock. Likewise the position of the appellees as

majority stockholders and their knowledge gained from close association with the corporation and with mining activities in general (tr. 71, 72, appendix pages 47-49 incl.) placed them in a position where their participation and collusion in the stipulated judgment constituted a breach of trust and was a fraud upon the corporation, the minority stockholders and the court. (See Sec. 5829, pages 161 to 166, and Sec. 5834, pages 173, 174, 175, *Fletcher Cyclopedia Corporations,* Permanent Edition, Vol. 13, appendix pages 56, 57, 58.)

The appellees had knowledge that the actions of the president of the corporation and the board of directors were illegal, and participated in collusion and connivance with the alleged president when they were parties to the stipulated judgment against the appellant corporation (tr. 71, appendix page 47). It is no defense to the actions of the appellees to assert that they were dealing at least with defacto officers of the corporation. In view of the allegations of the amended petition (tr. 71 et seq., appendix page 47), the appellees knew they were not dealing with defacto or dejure officers of the appellant.

The present officers of the corporation may sue in equity to vacate the judgment heretofore entered against the corporation because of the collusion between the alleged president and board of directors of the appellant corporation and the appellees at the time of the entry of the stipulated judgment. In. Sec. 5831, Fletcher Cyclopedia Corporations, Permanent Edition, Vol. 13, at page 169, it is provided as follows:

> "A suit will lie in equity to vacate a judgment obtained by collusion with corporate officers, or the stockholder may intervene in proper cases to open it or to prevent its entry by interposing a defense on behalf of the corporation."

A case directly in point, *Whitney vs. Hazzard,* 18 S. D. 490, 101 N. W. 346, is cited in the annotation to the above section. In that case the plaintiff and some thirty other individuals who claimed to be stockholders in a gold mining corporation brought an action against the defendant, Hazzard, and the gold mining company to vacate and set aside a decree of foreclosure entered in favor of Hazzard and against the corporation. The complaint alleged that in 1893 one Day, the president of the gold mining corporation, procured a loan from Hazzard through various agents to apply on payment of mining property in California which had been purchased by Day in his own name and for which Day gave his promissory notes to the persons named. To secure the notes Day and one Lewis, secretary of the company, executed to the parties notes and a mortgage in the name of the gold mining company, which notes and mortgage were assigned to Hazzard. In 1896, Day's note not being paid, an action was commenced by Hazzard and a decree of foreclosure was entered. The property of the mining company was sold thereon and bid in by Hazzard and the sale was subsequently confirmed. In 1900 the plaintiffs, having learned of facts concerning the fraudulent use of the mortgage by the said defendant, moved to vacate and set aside the decree. Hazzard appeared and filed an affidavit alleging that the mortgage was properly and

legally executed and he induced the court to deny the plaintiffs' motion by means of other false and fraudulent statements. However, in 1902 the plaintiffs came into possession of documents and all of the facts relating to the transaction which could show that they, Day and Hazzard, acted together, and that the decree against the gold mining company was obtained by collusion between Hazzard and Day. In stating the law applicable to this case, the court cited the Supreme Court of the United States in *United States vs. Throckmorton,* 98 U. S. 61, 25 L. Ed. 31. The court said as follows:

> "In that case the court, after discussing the general rule, says: "There is an admitted exception to this general rule in cases where, by reason of something done by the successful party to a suit, there was in fact no adversary trial or decision of the issue in the case. Where the unsuccessful party has been prevented from exhibiting fully his case by fraud or deception practiced on him by his opponent—as by keeping him away from court, a false promise of a compromise, or where the defendant never had knowledge of the suit, being kept in ignorance by the acts of the plaintiff * * * these and similar cases which show that there has never been a real contest in the trial or hearing of the case are reasons for which a new suit may be sustained to set aside and annul the former judgment or decree, and open the case for a new and fair hearing. (Citing cases.) In all these cases, and many others which have been examined, relief has been granted on the ground that by some fraud practiced directly upon the party seeking relief against the judgment or decree that party has been prevented from presenting all his case to the court * * *"

Likewise, the court continues further as follows:

> "Mr. Wells, in his very useful work on Res Adjudicata, says (section 499): 'Fraud vitiates everything, and a judgment equally with a contract—that is, a judgment obtained directly by fraud, and not merely a judgment founded on a fraudulent instrument; for, in general, the court will not go again into the merits of an action for the purpose of detecting and annulling the fraud. * * * Likewise, there are few exceptions to the rule that equity will not go behind the judgment to interpose in the cause itself, but only when there was some hindrance besides the negligence of the defendant in presenting the defense in the legal action.'" It appears from the complaint in the case at bar that there was no real contest on the trial or hearing of the case, and for this reason a new suit would be sustained to set aside or annul the former judgment or decree and open the case for a new and fair hearing." (*Whitney vs. Hazzard,* 101 N. W. Reporter, at page 347.)

Also see:

> *Manahan vs. Petroleum Producing & Refining Company,* 198 App. Div. 192, 189 N. Y. S. 127.

The amended petition (see apendix pages 49, 50, 51) indicates that the appellees knew from the offer made to them by John Sekulic (tr. 73, 74, 75) that they would by stipulating a judgment take all of the Clayton Silver Mines dividend stock, and they knew or they should have known from their relationship with their predecessors in interest, and their own subsequent activities with appellant corporation and others, that their so-called Class A common stock was issued without con-

sideration (tr. 54, 55, 56, 57, 58, appendix pages 38-42 incl.). In knowing what appellees actually knew about F. C. Keane's illegal position in assuming to act as president of the appellant corporation, they actually participated in a fraud upon the defendant corporation. It is interesting to note that immediately prior to the entry of the stipulated judgment and decree against the appellant corporation (tr. 48, 49, 50) an amendment to the prayer of appellees' complaint was filed (tr. 44, 45), which was as follows:

> "That the defendant, Independence Lead Mines Company be ordered and directed to forthwith distribute and deliver to these plaintiffs 250,000 shares of the capital stock of the Clayton Silver Mines, Inc., and account to the plaintiff, and pay to them, the sum of Three Thousand ($3,000.00) Dollars, being the dividend declared and paid thereon as herein alleged.
>
> "In the event defendant is unable to deliver said 250,000 shares of Clayton stock to the plaintiffs in full, that then said judgment or decree order and direct the defendant to make the plaintiffs whole with respect to so many shares of said stock as the defendant is unable to deliver to the plaintiffs by payment to plaintiffs of such sum as the Court shall determine meet and equitable, or by such other means as the Court shall determine."

It would thus appear that appellees knew of the situation in the appellant corporation and that they deliberately took from the corporation by their stipulated judgment all of the Clayton Silver Mines stock which then was held by the appellant and which had

become a trust for the benefit of the common stockholders of the appellant corporation by a resolution previously entered (tr. 67, 68). It seems well settled that a trust fund was in fact created for the benefit of the stockholders at the time of the declaration of dividends to the common stockholders from the Clayton Silver Mines stock held by the appellant corporation. See *In Re Interborough Consolidated Corporation,* 288 Fed. Reporter 334-349. Likewise, at 14 *Corpus Juris,* Page 816, Section 1238, we find the following:

> "But where a corporation has not only declared a dividend but has specifically appropriated and set apart from its other assets a fund out of which the dividend is to be paid, such action constitutes the assets so set apart a trust fund in the hands of the corporation for the payment of the stockholders to the exclusion of other creditors."

It seems pertinent to inquire why the appellees and the appellant corporation, through its alleged president at the time of the stipulation, settled for 170,000 shares of Clayton Silver Mines stock and no more or less, that amount of stock being at the time of the settlement and stipulation all of the Clayton Silver Mines stock owned by the defendant corporation. Likewise, if the appellees and the appellant corporation's alleged president at the time of the stipulated judgment were dealing at arm's length, why did they agree on the surrender by the appellees to the appellant corporation of 400,000 shares of their so-called common stock Class A, and why was it that appellees did not accept a settlement on a ratio which had been paid to the

common assessable stockholders? It would seem that if the common stock Class A owned by the appellees was valid and was not a void issue for lack of consideration that it was unnecessary to surrender for cancellation any of such stock (tr. 46).

The amended petition alleges clearly that the appellees wilfully closed their eyes to information in respect to fraudulent transactions which were not only within their reach but which were actually known to them. The notice of this fraud under the allegations of the amended petition is directly imputed to the appellees. (*Wecker vs. Enameling Company,* 204 U. S. 176, 185; 51 Law Ed. 430). The appellees as a matter of fact had actual knowledge. There was no question of any strained construction of the law of notice in order to impute it to them.

CONCLUSION

We are confident that the court will agree with the position taken in this brief that the appellees were not minority or majority stockholders standing in an arm's length position to the appellant corporation at the time they entered into their stipulated judgment. The disposition of this case, so far as the merits of the controversy are concerned, relates solely to whether or not the appellant's amended petition alleges sufficient facts, which must be deemed to be admitted by the appellees herein, to constitute ground for the taking of evidence as to the merits of the facts alleged in respect to the fraud participated in by the appellees in the procurement of what we believe to be a collusive judgment against the appellant corporation and its stockholders. We submit that if the allegations contain facts bringing the charge of fraud and collusion of the appellees within the application of the doctrine of extrinsic fraud, then the order and decree of the lower court should be reversed and the issues made in the amended petition should be determined on the merits of proof offered in support thereof. We submit that the allegations in the amended petition entitle the appellant to offer proof in support of its amended petition. (*Pacific R. Co. vs. Missouri P. R. Co.,* 111 U. S. 505, 28 L. Ed. 498.) It appears from the facts alleged that the so-called president of the appellant corporation, F. C. Keane, acting illegally and as an alleged officer of the company, dissipated almost all of its assets, and that while acting as its attorney as

well as its alleged president he attempted to protect himself by resort to a fraudulent compromise and stipulated judgment against the interests of the appellant corporation. The amended petition also shows that the appellees dealt with the alleged president of the appellant corporation, F. C. Keane, as an officer and director, full knowing that he was legally incapable of acting in such capacity. Therefore the appellees were knowingly parties to a fraudulent compromise and stipulated judgment against the appellant corporation, with Keane, the attorney for the corporation, protecting Keane, the defalcating officer.

Respectfully submitted,

R. MAX ETTER,

WILLIAM E. CULLEN,

WALTER H. HANSON,

Attorneys for Appellant.

Appendix

IN THE DISTRICT COURT
OF THE
UNITED STATES OF AMERICA
IN AND FOR THE DISTRICT OF IDAHO
NORTHERN DIVISION

ALMA KINGSBURY and OLGA MARQUARDT, *Plaintiffs,* *vs.* INDEPENDENCE LEAD MINES COMPANY, an Arizona Corporation, *Defendant.*	No. 1603-N (Amended) MOTION TO VACATE AND SET ASIDE JUDGMENT AND REOPEN SAID CAUSE TO ALLOW INDEPENDENCE LEAD MINES COMPANY TO FILE A PROPER ANSWER AND TO REOPEN SAID CAUSE FOR TRIAL.

Now Comes the above named defendant, Independence Lead Mines Company, an Arizona Corporation, and petitions this Court to vacate and set aside the judgment heretofore rendered on the 24th day of June, 1946, by stipulation without argument or trial, for the following reasons, to-wit:

I.

That said judgment provides for the distribution to said plaintiff, Alma Kingsbury, of 400,000 shares of stock of the defendant Company known as "Class

'A' Non-assessable Common Stock'' and also provides for the distribution to OLGA MARQUARDT of 200,000 shares of such stock and said defendant Company alleges that no consideration has ever been paid to said Company for said stock and the same is wholly without consideration and void and if said judgment is to stand the said judgment should be amended to provide for the payment unto the defendant Company by said plaintiff, ALMA KINGSBURY, of $400,000.00 in lawful money of the United States of America and the payment to said defendant Company by said plaintiff, OLGA MARQUARDT, of the sum of $200,000.00 in lawful money of the United States of America, so as to make the said stock fully paid; where otherwise the said stock is a fraud upon the stockholders of the said defendant Company and is wholly without consideration and should be returned to the treasury of the said defendant Company.

II.

That at the time of the incorporation of the said defendant Company under the laws of the State of Arizona a capitalization of said Company was made with 3,000,000 shares of ''Common Assessable Stock'' of the par value of $1.00 per share and 1,000,000 shares of stock called ''Preferred, Non-Assessable Stock'' of the par value of $1.00 per share and later on or about the 10th day of February, 1932, said Articles of Incorporation were amended so as to provide that the said ''Non-assessable Preferred Stock'' of the par value of $1.00 per share would surrender its prefer-

ence and would become and would be known as "Class 'A' Non-Assessable Common Stock" of the par value of $1.00 per share; and representations were made at said time to all of the stockholders by its officers, including its President and Secretary, that the said stock would be held in the treasury of the Company as unpaid treasury stock subject only to being transferred or exchanged by the said defendant Company in the purchase of other mining properties from time to time during the existence of the said defendant Company.

That no new properties were ever purchased by the defendant Company in accordance with the expressed intention and representations of the officers and directors and trustees of the said Company to make said stock fully paid and said stock was and is wholly unpaid and should be returned to the treasury of the Company.

That during the year 1923, or thereabouts, Henry B. Kingsbury and Herman Marquardt, being then and there the President and Secretary, respectively, of the Independence Lead Mines, Ltd., an Idaho corporation, predecessor in interest to the mining properties of the defendant Company in the Hunter Unorganized Mining District in Shoshone County, Idaho, formed a corporation under the laws of the State of Idaho under the name of MINES FINANCE COMPANY, and the said Henry B. Kingsbury became the President thereof and the said Herman Marquardt became the Secretary and Treasurer thereof, and the said Kingsbury and the

said Marquardt became and were the sole stockholders of said MINES FINANCE COMPANY.

That the objects and purposes of the said Mines Finance Company were to take and receive all funds secured by the levying of assessments on the common stock of the Independence Lead Mines, Ltd., and to disburse the same under the direction and for the use and purposes of the President and Secretary of the said Mines Finance Company, being Henry B. Kingsbury and Herman Marquardt, who were the sole stockholders thereof, without any regard to the purposes for which said assessments were levied and to defraud the stockholders of the Independence Lead Mines, Ltd., of all control of the funds so secured by the levying of assessments and which said funds should have been deposited to the credit of the said Independence Lead Mines, Ltd., in its own treasury; and the said Mines Finance Company had no other source of revenue or income whatsoever; and the said Mines Finance Company continued to carry out such course of action until the formation of the present Company under the laws of the State of Arizona, being the defendant Company herein, and after the organization of said defendant Company the said Henry B. Kingsbury, Manager or President and controlling officer of both the Independence Lead Mines, Ltd., and the defendant Company, and Herman Marquardt, Secretary and Treasurer of said Companies; and likewise President and Secretary and Treasurer, respectively, of the Mines Finance Company, continued to levy assessments upon

the assessable stock of the defendant Company and to place said funds as levied in the Mines Finance Company for disbursement for their own purposes and accounts and in fraud of the assessable stockholders of the defendant Company; and between the time of the formation of the defendant Company and the end of the year 1938, the said Kingsbury and Marquardt levied thirteen (13) assessments upon the assessable stock of the defendant Company in the sum of 1c or 2c per share, amounting to many thousands of dollars of money levied upon and from the stockholders owning and holding the assessable common stock of the defendant Company and no assessments levied were ever levied upon or paid by the so-called "Class 'A' Non-assessable Common Stock" of the defendant Company and said stock is wholly unpaid and without any consideration.

III.

That at some time during or after the year 1930, the said Kingsbury and the said Marquardt, being then and there the Manager and Secretary of the defendant Company and directors and officers of said Company, and being then and there in complete control of the defendant Company and at the same time being, respectively, the President and Secretary of the Mines Finance Company and the sole stockholders thereof and in complete control thereof, for the purpose of unlawfully and illegally acquiring for themselves the ownership of the said 1,000,000 shares of "Class 'A' Non-assessable Stock" of the defendant Company, and

in violation of all representations heretofore alleged to have been made to the holders of common assessable stock, caused the same to be transferred to the Mines Finance Company of which the said Kingsbury and the said Marquardt were, respectively, President and Secretary and officers and directors thereof, and the sole stockholders thereof, without any consideration of any kind whatsoever being given for the said stock by the Mines Finance Company or the said Kingsbury or the said Marquardt, or any of them, and the said "Class 'A' Non-assessable Common Stock" of the defendant Company remained and is wholly unpaid and constitutes and is a fraudulent issue of stock of said defendant Company; and upon and against the holders of the common assessable stock of said defendant Company.

IV.

That the said Henry B. Kingsbury died during the month of June, 1940, leaving as his widow and sole heir at law the plaintiff, Alma Kingsbury, and the said Alma Kingsbury thereupon, through probate, became the owner of the stock in the Mines Finance Company theretofore held by her husband, Henry B. Kingsbury, and became an officer and director and stockholder in said Mines Finance Company.

That on or about the 31st day of December, 1941, the said Alma Kingsbury, being then and there an officer and director of the Mines Finance Company and the holder of two-thirds of the stock of said Mines

Finance Company, and the said Herman Marquardt being then and there an officer and director of the Mines Finance Company and the owner of the remaining stock thereof, being a one-third interest in the stock of the said Company, conspired together and caused to be issued unto themselves, without any consideration whatsoever, the "Class 'A' Non-Assessable Common Stock" of the defendant Company, being 1,000,000 shares of stock of the par value of $1.00 per share, for which no consideration had ever been paid into the treasury of the defendant Company and issued two-thirds of said "Class 'A' Non-Assessable Common Stock," being 666,666⅔ shares of stock to Alma Kingsbury and 333,333⅓ shares of stock to the said Herman Marquardt; and the same was then and is now a continuing fraud upon the stockholders of the defendant Company and the holders of the common assessable stock thereof.

That on or about the 29th day of August, 1942, the said Herman Marquardt died testate in the County of Shoshone, State of Idaho, leaving as his sole heir his wife, Olga Marquardt, who succeeded to the ownership of said one-third share of the 1,000,000 shares of "Class 'A' Non-Assessable Common Stock" of the defendant Company in fraud of the rights of the holders of the common assessable stock of the defendant Company and without any consideration of any kind being paid therefor.

V.

That the said Henry B. Kingsbury and the said Herman Marquardt, being then and there officers, directors and trustees of the defendant Company in carrying out their intent to defraud the holders of the common assessable stock of the defendant Company and to defraud the said Company, illegally and against the laws of the State of Arizona and the State of Idaho, presented and issued and signed as President and Secretary all certificates of stock in the defendant Company as common stock of the par value of $1.00 per share of 4,000,000 shares and did not print, or cause to be printed, upon said certificates or any of them, as required by the laws of the State of Arizona and the State of Idaho and the general laws of the states forming the United States of America, the differentiation in the classes of the two stocks so as to show to the sockholders and the purchasers of said stock that 3,000,000 shares of the common stock of the defendant Company were assessable stock and 1,000,000 shares of stock so held by the Mines Finance Company and later transferred to the plaintiffs, Alma Kingsbury and Olga Marquardt, as hereinbefore set forth, were non-assessable stock of the par value of $1.00 per share for 1,000,000 shares, designated and shown as "Class 'A' Non-Assessable Common Stock" and thereby worked a fraud upon the holders of the 3,000,000 shares of assessable common stock, which fraud is a continuing one; the intent and purpose of said Kingsbury and said Marquardt being thereby the ownership of said "Class 'A' Non-Assessable Com-

mon Stock" to remain in permanent control of said Company without paying assessments while levying unlimited assessments on the common assessable stock and the said stockholders had no knowledge of the difference in the classes and values of said stock and all of the said stock being 1,000,000 shares of "Class 'A' Common Stock" is a fraudulent issue and should be set aside and returned to the treasury of the said Company for cancellation as non-assessable stock.

VI.

That the defendant Company, the Independence Lead Mines Company, since the death of Herman Marquardt in August, 1942, has been under the control and domination of F. C. Keane, of Wallace, Idaho, who acted as President of the Independence Lead Mines Company without any right or authority, as he was not a stockholder in said Company and had not been since sometime in the year 1940, and the said F. C. Keane, without any right or authority, appointed as so-called co-directors of the defendant Company, Glynn D. Evans and William Mullen of Wallace, Idaho, who served as officers and directors of said Company unlawfully and without any right or authority as neither the said Evans nor the said Mullen were ever, at any time, stockholders of the Independence Lead Mines Company and had no right or authority to act as such directors or officers.

That the said defendant is in possession of a sworn and verified written statement, dated November 29,

1947, made by William Mullen of Wallace, Idaho, that he was never appointed a Director of the Independence Lead Mines Company and never acted as such Director and never had any knowledge that he had been so appointed a Director or was held out to be a Director until long after the judgment had been entered in this controversy and that he never acted as a Director in any way; the said defendant has also in its possession an affidavit by Glynn D. Evans of Wallace, Idaho, dated November 29, 1947, to the effect that he never knew of any of the sales of the stock of the Clayton Silver Mines Company owned by the Independence Lead Mines Company being made and never authorized or agreed to the same.

That in August, 1944, the so-called Board of Directors of the Independence Lead Mines Company, or at least F. C. Keane and Glynn D. Evans, caused a dividend to be declared from the treasury of the company of stock of the Clayton Silver Mines Company, and that a portion of the meeting of the Board of Directors of that date is hereinafter quoted:

> 'WHEREAS, the stockholders of Independence Lead Mines Company are insistent upon the distribution of a substantial portion of said Clayton Silver Mines stock,
>
> NOW THEREFORE, BE IT RESOLVED that a distribution of 750,000 shares of the capital stock of Clayton Silver Mines be made to the common stockholders of Independence Lead Mines Company on the basis of one (1) share of Clayton Silver Mines for four (4) shares of Independence Lead Mines

Company stock held by all common stockholders, said distribution to commence on the 20th day of September, 1944, and that the shareholders of this company be required to send in their Independence Lead Mines Company stock for the purpose of receiving the Clayton dividend and that the Secretary stamp the Independence Lead Mines Company certificates so sent in showing that the Clayton Silver Mines distribution on said stock had been effected.

BE IT FURTHER RESOLVED that the Class A common stock of Independence Lead Mines Company do not participate in such distribution for the reason that there is a question as to the validity of said Class A common stock.'

That at the time of said meeting and the dividend declared thereat, there were outstanding 2,744,700 shares of issued assessable common stock of defendant company. The Company, after setting enough Clayton aside for this dividend had left undeclared in its treasury 314,825 shares of Clayton stock. Prior to the stipulation and judgment entered in this action, the said F. C. Keane had sold 218,000 shares of Clayton stock belonging to the treasury of the defendant Company and had converted the sales price of said stock to his own account and to his own personal use and benefit.

That at the time of the stipulation and judgment entered in this action the defendant Company had left in its treasury 96,825 shares of Clayton stock and had under its control 73,175 shares of Clayton previously declared, as above set forth, as a dividend to the com-

mon assessable stockholders, but as of that time undistributed.

That said 73,175 shares of Clayton were held in trust by the defendant Company and its then so-called officers for stockholders of the common assessable stock.

That on or about the 23rd day of June, 1945, the said Alma Kingsbury and Olga Marquardt, being then and there the holders of said "Class 'A' Non-assessable Common Stock," as aforesaid, caused this action to be instituted in this Court against the Independence Lead Mines Company, defendant, and the said defendant appeared through its President, F. C. Keane, in said cause and by answer alleged that the said issuance of said "Class 'A' Common Stock" and the holding thereof by the said plaintiffs, Alma Kingsbury and Olga Marquardt, was fraudulent and a fraud upon the holders of the common assessable stock of the said Company, and thereafter, without argument and without trial, the said F. C. Keane and certain of his co-attorneys in this action entered into a stipulation with the said plaintiffs by and through their attorney, H. J. Hull, of Wallace, Idaho, to settle the said controversy without argument or trial by alloting to the plaintiff, Alma Kingsbury, 400,000 shares of the "Class 'A' Non-assessable Common Stock" of the Independence Lead Mines Company and by alloting to the said plaintiff, Olga Marquardt, 200,000 shares of the "Class 'A' Non-assessable Common Stock" of the Independence Lead Mines Company and by further allowing and awarding to said plaintiffs in said proportion 170,000 shares

of stock of the Clayton Silver Mines Company and by further allowing and awarding to said plaintiffs the sum of $10,050.00 and causing judgment to be entered and rendered against the defendant Company, in accordance with the terms of said stipulation aforesaid; and this Court, on the 24th day of June, 1946, entered such judgment in accordance with said stipulation. The defendant Company, the Independence Lead Mines Company, now asserts that the said judgment is fraudulent and is a fraud upon this Court and this defendant Company, and makes this motion to set aside the same so this defendant can assert its lawful rights and defend and protect the rights of the holders of the common, assessable stock of this defendant Company; that no disclosure was made to this Court that the award of 170,000 shares of Clayton to the plaintiffs would deprive common assessable stockholders of a dividend previously declared, in the amount of 73,175 shares of Clayton which was a trust for said common stockholders held by the defendant Company and its so-called President, F. C. Keane.

VII.

That F. C. Keane, acting as President of the defendant Company, the Independence Lead Mines Company, was in complete control thereof and had sold and disbursed all of the assets of said Company for his own use and benefit, as set forth in the complaint for Receivership, now pending in this Court in the case of *L. J. Hopkins et al vs. Independence Lead Mines Company et al,* being Civil Cause No. 1687 to which

reference is hereby made. And the said plaintiffs, well knowing that no stockholders' meeting of the stockholders of said defendant Company had been held for a period of eight (8) years, and well knowing that there was no legally elected Board of Directors existing and that said so-called Board was illegal, dealt with said F. C. Keane in making said settlement, well knowing at the time that any action taken by the said Keane was illegal and void.

Upon information and belief the said defendant alleges the following, to-wit: That the said plaintiffs, prior to, and during the litigation herein, have claimed to be by many times the largest stockholders of the Independence Lead Mines Company and during said time lived in the Town of Wallace, Idaho, and for a part of said time had maintained therein the principal brokerage office and brokerage business in Wallace, known as Pennaluna & Company, and during all times were in close touch with the said business and knew of the affairs of the said Independence Lead Mines Company and were fully aware that F. C. Keane was not in fact legally the president of the said Company and well knew that said Company had no legal Board of Directors and well knew that the said F. C. Keane was selling large blocks of the Clayton Silver Mining Company stock held by the said Independence Lead Mines Company in its treasury and was applying the proceeds thereof to his own use and was dissipating the same; and the said plaintiffs claim to be such large stockholders of the Independence Lead Mines Com-

pany that they were in virtual control thereof; that the said plaintiffs failed and neglected to interfere in the affairs of the said Company well knowing that the same was being bankrupted by the so-called president of the said Company for the reason that they could secure and obtain a better settlement in connection with their own affairs and their ownership of the disputed Class "A" stock and the Clayton dividend that they claimed was due thereon by dealing with the said so-called president who desired to conceal the true condition of the affairs of the said Company and his own misdeeds in connection with its operations; and that by reason of the above said plaintiffs were fully cognizant of all said matters for a long time prior to the settlement made in this case and the judgment entered therein.

Defendant also alleges that on or about July, 1945, or shortly thereafter, and prior to the making of the said settlement and the entry of the stipulated judgment, the said plaintiffs and their said attorney became alarmed at the large sales of stock of the Clayton Silver Mines Company belonging to the said Independence Lead Mines Company and notified, in writing, the said Clayton Silver Mines Company and its officers at its office in Wallace, Idaho, to stop forthwith all further transfers of Clayton stock belonging to the Independence Lead Mines Company and that if any further transfers of said stock were made on the books of the said Clayton Silver Mines Company they would immediately bring injunction proceedings to prevent

further disposition and transfer of said stock as aforesaid.

Upon information and belief, the said defendant alleges the following: That the doings and transactions of the said F. C. Keane in regard to dissipating the cash and funds of the Independence Lead Mines Company and selling the stock of the Clayton Silver Mines Company belonging to the Independence and squandering and dissipating the funds realized therefrom for his own benefit, and the extent of the possession by the Independence Lead Mines Company of the sum of only 170,000 shares of Clayton, including over 73,000 shares held in trust for common assessable stockholders, were well known in all particulars to the said plaintiffs long prior to the settlement made in this controversy and the judgment entered therein.

That sometime prior to said settlement and compromise made in this action, one John Sekulic, being then and there a resident of the Town of Mullan, Idaho, promised and agreed with the said F. C. Keane that he could and would arrange a compromise and settlement of said controversy which the said F. C. Keane proposed to him (and by which proposal the said Keane instructed the said John Sekulic to propose to plaintiffs that Keane would pay over to them all of the stock of the Clayton Silver Mines Company remaining in the treasury of the Independence Lead Mines Company and also stock held as dividend previously declared by defendant and unsold by the said F. C. Keane and amounting in all to 170,000 shares of said Clayton

Silver Mines stock and for the sum of $10,050.00 cash additional and also 600,000 shares of the Class "A" Common Stock, the legality of said Class "A" stock being then and there in dispute) providing the said F. C. Keane would pay to him, the said John Sekulic, the sum of $10,000.00 cash as his fee and compensation for his said services immediately the said compromise and settlement was effected; and that further the said John Sekulic would inform the said plaintiffs that if they would not accept the said settlement they would receive nothing by any judgment secured against the Independence Lead Mines Company for the reason that said F. C. Keane would sell and dispose of all the remainder thereof and apply the funds to his own use and that he, the said John Sekulic, would further inform the said plaintiffs that the aforestated amount of stock of the Clayton Silver Mines Company was all of the stock remaining in the treasury, including stock that had been declared as a dividend but had not been paid out at the time to the common assessable stockholders and remained unclaimed as part thereof; that the said F. C. Keane agreed to pay to the said John Sekulic the sum of $10,000.00 as his fees and compensation for his services in the same; that said John Sekulic immediately after said agreement approached said plaintiffs, or one of them, and arranged and made a compromise and settlement with the said plaintiffs upon the terms agreed and as set out aforesaid, and when he informed the said F. C. Keane that plaintiffs, in view of the circumstances heretofore related, would compromise their said claim, the said F. C. Keane

caused a stipulation to that effect to be entered in the pleadings in this cause and a judgment to be entered by this court carrying out the terms of the said settlement; and the said F. C. Keane paid over or caused to be paid over to the said John Sekulic the sum of $10,000.00 as his fees and compensation for his services therein.

That at the time said compromise and settlement was made by the said John Sekulic the said plaintiffs by reason of the foregoing had full and complete knowledge of all of the said affairs of the Independence Lead Mines Company and well knew that they were securing all of the Clayton stock left in the possession of the Independence Lead Mines Company and including many shares of stock which were being held in trust by the said Company for the use and benefit of certain stockholders other than the plaintiffs under a dividend declared to them by said Company in August and September, 1944.

That for a long period of time the said Independence Lead Mines Company, and more particularly its president, F. C. Keane, for his own purposes and for the purpose of concealing the true condition of the affairs of said Company, neglected, failed and refused to file a report for the year 1943 and for the year 1944 and for the year 1945, as required by the rules and regulations of the Securities and Exchange Commission of the United States of America, and the rules and regulations of the Standard Stock Exchange of Spokane, Washington, and the rules and regulations of the Spo-

kane Stock Exchange of Spokane, Washington; and the Secretary of the Securities and Exchange Commission threatened to withdraw the said stock from its registration and from its trading on the Standard Stock Exchange and on the Spokane Stock Exchange unless such reports were filed, so that, on or about the 20th day of March, 1947, such reports were filed with an audit by L. J. Randall, a certified public accountant of the City of Wallace, Idaho, and which said reports were signed and filed by F. C. Keane as president of the Independence Lead Mines Company and by Glynn D. Evans as Secretary of the said Company, as accurate and correct reports in regard to the condition of the affairs of the Independence Lead Mines Company; that an additional report for the year 1946 was not filed as aforesaid until on or about the 20th day of May, 1947.

VIII.

That Chase A. Horning, of Wallace, Idaho, acting as one of the attorneys for the defendant, was paid and received the sum of $10,000.00 from the said defendant in said settlement; and the said F. C. Keane, acting as one of the attorneys for said defendant, also received the sum of $10,000.00 from said defendant.

IX.

That the said plaintiffs have never carried out the terms of settlement incorporated in the judgment of this Court on June 14, 1946, in that they have never

returned, or offered to return, to the treasury of the defendant Company, 400,000 shares of "Class 'A' Non-Assessable Common Stock" as provided in said judgment.

X.

That the said 1,000,000 shares of "Class 'A' Common Non-Assessable Stock" was transferred by them, the officers of the defendant Company, as is more fully set forth in paragraph III herein, and in complete control thereof, acting in collusion with themselves as officers of the Mines Finance Company and in complete control thereof and without any right or authority and the same is wholly void.

That the facts in regard to this transfer and other matters set out herein were never disclosed or discovered until after the new Board of Directors of the Independence Lead Mines Company were elected on the 26th day of May, 1947, and had acquired some of the books and documents and papers of the said Company; that all of the books of said Company have not, as yet, been turned over to the new Board of Directors.

That F. C. Keane, as one of the attorneys of record for the defendant Company, as well as its President and dominating director, by his actions prevented the defendant Company from presenting its defenses to this Court; that said F. C. Keane by filing his answer in this cause and by allegations therein contained caused stockholders to believe said matter would be contested; that the later stipulation and judgment pre-

vented stockholders from intervening in this cause; that the true state of affairs as regards the giving to the plaintiffs of the 73,165 shares of Clayton held in trust for common, assessable stockholders was not, and could not be, discovered until a new Board of Directors took possession of the books and records of the Company, as all facts were concealed by said Keane, for his own purposes and against the rights and in fraud of the interests and rights of the assessable stockholders of said Company and in fraud of this Court.

WHEREFORE, Independence Lead Mines Company, defendant, prays that the Court enter an order in the above entitled case providing as follows:

1. That the judgment of the Court heretofore entered in the above entitled cause on the 24th day of June, 1946, be vacated and set aside and held for naught.

2. That the parties hereto be restored to the same status as that obtaining upon the filing of the complaint in the above entitled case.

3. That defendant, Independence Lead Mines Company, be granted twenty days following any order of this Court vacating and setting aside the judgment heretofore rendered, for the purpose of pleading to said complaint by motion or answer as provided in the Federal Rules of Civil Procedure.

4. For such other relief as to the Court may seem just and equitable in the premises.

R. MAX ETTER,

WILLIAM E. CULLEN,
Attorneys for Defendant.

Post Office Address:
726 Paulsen Building,
Spokane, Washington.

(VERIFIED)

Fletcher Cyclopedia Corporations, Permanent Edition, Vol. 13, Sec. 5829, pages 161 to 166:

"If the corporate officers or majority stockholders threaten or commit acts which constitute a breach of trust, or are fraudulent or unfair or otherwise wrongful, even if the acts are not beyond the powers of the corporation nor positively forbidden by statute or public policy, minority stockholders may sue to prevent or redress such injuries, provided the suing stockholders are themselves directly or indirectly injured by such acts, have not participated in or consented to such fraudulent or wrongful acts, act promptly, and provided further, as in all stockholders' suits, relief cannot be obtained through the corporation itself. As has been well said, 'while courts cannot compel directors or stockholders, proceeding by a vote of the majority, to act wisely, they can compel them to act honestly, or undo their work if they act otherwise.'

"What constitutes fraud depends largely upon the facts of the particular case. In a clear case of fraud, little or no difficulty is experienced in granting relief; but there are many cases which involve acts which cannot be said to be actually fraudulent but which are wrongful as a breach of the trust imposed on those controlling the corporation, although within the powers of the corporation, and as to which relief will be granted minority stockholders. So the liability may be based on acts constituting actionable negligence. It is immaterial that the scheme is lawful on its face, and the rule has been laid down that 'where a majority of the directors, or stockholders, or both, acting in bad faith, carry into effect a scheme which, even if lawful upon its face, is intended to circumvent the minority stockholders and defraud them out of their legal rights, the courts interfere

and remedy the wrong.' Fraud, as the term is used in this connection, includes acts really oppressive to the minority stockholders, provided they are not merely a good-faith exercise of discretion in the management of the corporation; and the test as laid down in a leading case and generally followed or reiterated in other decisions and by other courts, at least as far as injunctive relief against majority stockholders is concerned, is that, 'in order to warrant the interposition of the court in favor of the minority stockholders * * * where such action is within the corporate powers, a case must be made out which plainly shows that such action is so far opposed to the true interests of the corporation itself as to lead to the clear inference that no one thus acting could have been influenced by any honest desire to secure such interests, but that he must have acted with an intent to subserve some outside purpose, regardless of the consequences to the company, and in a manner inconsistent with its interests.'

"Equity will never countenance any scheme to defraud, no matter how novel and ingenious. Actual dishonesty of those in control is not necessary. Fraud need not be shown as a fact nor need the individual stockholders be actuated by any fraudulent intent, but it is sufficient that the existence of fraud is the necessary legal inference from facts found."

Fletcher Cyclopedia Corporations, Permanent Edition, Vol. 13, Sec. 5834, pages 173, 174, 175:

"While a stockholder may deal with the corporation, the dealing must be fair and free from actual fraud. If the owners of a majority of the stock of a corporation take advantage of their position and of their influence over the directors or other officers, to obtain an inequitable contract

with or conveyance or lease from the corporation, they perpetrate a fraud upon the minority, and the contract, lease or conveyance will be set aside in equity at the suit of dissenting stockholders. However, there is no presumption of fraud in a contract between a corporation and a majority stockholder, merely because of the relationship of the parties. But such contracts will be scrutinized with much greater care than if made with a third person. Even where fraudulent, such contracts are valid until set aside. It is no objection to setting aside a mortgage given by a corporation to the majority stockholder, as fraudulent, that at the stockholders' meeting authorizing the mortgage there was no dissenting vote.

"On the other hand, it is not fraudulent for a majority of the stockholders to purchase property needed by the corporation, at a time when it had no money to make the purchase, and thereafter, on fully disclosing all the facts, to sell it to the corporation at a large profit, although at its fair value. A lease by a majority stockholder to the corporation cannot be attacked where he is willing to convey the property to the company for what it cost him."